Internal Revenue Service

memorandum

CC:TL-N-5637-88
Br2:DCFegan

date: APR 22 1988

to: Regional Counsel CC:MA
Mid-Atlantic Region
Attn: Eugene J. Wein

from: Director, Tax Litigation Division CC:TL

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subject: [redacted]

This is in reply to your request for technical advice concerning the above-captioned case. This advice confirms informal advice transmitted to Mr. Eugene Wein of your office in a series of conversations over the past few months with Mr. David Fegan of our office.

The issue is whether certain interest earned by a cooperative and distributed to its patrons is deductible as patronage income under section 1382(b) of the Internal Revenue Code.

The petitioner is a buying, warehousing, and marketing cooperative serving retail sales businesses. Primarily it serves its patrons by giving them the advantages of being able to buy in bulk, in quantities similar to the large national retail chains. In order to pay for such bulk purchases, which are generally made on a weekly basis, the patrons are required to pay the petitioner three or four days in advance. During the intervening days, the taxpayer routinely invests the monies in interest-bearing repurchase agreements with various banks. In other words, the petitioner earns interest on the "float". This interest income is distributed to the patrons in proportion to their business conducted with the petitioner.

Apparently, several years ago we advised Appeals we disagreed with the decision in Cotter and Company and Subsidiaries v. United States, 765 F.2d 1102 (Fed. Cir 1985), and planned to issue an A.O.D. expressing disagreement with that decision. Indeed, the A.O.D. was subsequently issued and numbered CC-1986-032. The A.O.D. states we will continue to litigate the issue as to whether interest income is patronage sourced in appropriate cases.

We do not believe this is an appropriate case to advance our position. This case, like Illinois Grain Corporation v. Commissioner, 87 T.C. 435 (1986), concerns very short-term debts. Debt instruments with long terms are akin to investments;

whereas, debt instruments with short terms tend to resemble only temporary money management. Washington-Oregon Shippers Cooperative, Inc. v. Commissioner, T.C. Memo. 1987-32. The term of the debt instrument has been such a crucial factor in recent cases that we see little prospect of the Commissioner prevailing in the subject case. Moreover, as a matter of overall litigation strategy, we believe it best to advance our position in cases having a stronger factual foundation.

We prefer you not litigate this case. We understand the petitioner has expressed an interest in settling this issue on a basis involving its concession of approximately 12 to 20 percent of the amount in issue, perhaps for both suit years and nonsuit years. We urge you to secure and accept the most favorable settlement terms available. Should concession of the issue be the only alternative to trial, we recommend the issue be conceded.

MARLENE GROSS

By: Alfred C. Bishop, Jr. /a/
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